ilpa INSTITUTIONAL LIMITED PARTNERS ASSOCIATION

2024

# NAV-Based Facilities

## Guidance for Limited Partners and General Partners

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**ABOUT ILPA**

The Institutional Limited Partners Association (ILPA) empowers and connects limited partners to maximize their performance on an individual, institutional and collective basis.

With more than 600 member organizations representing more than 3 trillion USD of private equity assets under management, ILPA is the only global association dedicated exclusively to advancing the interests of LPs and their beneficiaries through best-in-class education, content, advocacy and events.

# Executive Summary

Net Asset Value (NAV)-based financing facilities have been commonly used in secondaries, private credit, and real estate for some time, but their prevalence in private equity strategies has noticeably increased in recent years. Understanding around these products is relatively nascent, and limited transparency around their use inhibits Limited Partners' (LPs') understanding of the impacts of these facilities, including costs and any risks. Additionally, Limited Partnership Agreements (LPAs) often do not explicitly address NAV facilities, leading to differing approaches among General Partners (GPs) in engaging LPs around their use, as well as a spectrum of approaches to reporting.

This guidance provides general parameters for improving transparency and encouraging a more productive dialogue between LPs and GPs around NAV-based facilities. Given the unique nature of these facilities, and the broad range of practices associated with their use, the recommendations that follow are not intended to be universally appropriate or applicable in every instance.

Additionally, this guidance specifically focuses on recommended practices and disclosures related to utilization of NAV facilities for private equity strategies where the facility is structured as asset-based debt at the fund level. For the avoidance of doubt, this guidance does not address the use of NAV-based facilities in other contexts, i.e., secondaries, private credit, or closed-end real estate funds.

This guidance was developed with the thoughtful feedback of ILPA member LPs, as well as GPs, law firms, lenders, and rating agencies among others committed to developing a shared set of expectations around the use of these facilities in the industry.

## Guidance Highlights

**PART 1:**
**Overview of NAV-Based Facilities and Current Market Practices** – A discussion of how NAV-based facilities are structured, the roles of lenders and rating agencies and how the PE industry is currently using NAV facilities.

**PART 2:**
**LP Concerns Regarding NAV-Based Facilities** – A review of challenges that LPs face when their managers use NAV-based facilities. This includes limited transparency and governance around NAV facilities, and specific challenges when a facility is used for a distribution or to support the existing portfolio.

**PART 3:**
**Recommendations for Improved Transparency and LP Engagement** – ILPA recommends that if the LPA does not give explicit permission to utilize a NAV facility GPs should engage the LPAC for consent prior to implementing a facility. ILPA also recommends that GPs should engage the LPAC for consent to utilize a NAV-based facility if the intended use case is for a distribution, regardless of LPA language.

**PART 4:**
**Proposed Legal Documentation** – ILPA recommends that GPs and LPs adopt language in LPAs moving forward that set guardrails around permissible uses of NAV-based facilities. This legal language should appropriate define "NAV-based Facilities" and set a clear limit to the amount a GP is able to incur through a NAV facility over the life of the fund.

**PART 5:**
**Recommended Disclosures Related to the Use of NAV-Based Facilities** – ILPA recommends that GPs disclose the rationale for the facility, the key terms of the facility and how any conflicts related to the facility were managed to all LPs in the fund.

PART 1:

# Overview of NAV-Based Facilities and Current Market Practices

# Overview of NAV-Based Facilities and Current Market Practices

## Background

Net asset value (NAV)-based financing facilities have been commonly used in secondaries and private credit for some time, but their prevalence in private equity strategies has noticeably increased in recent years. The Fund Finance Association estimates that the market for NAV-based facilities is currently 100 billion USD and is expected to grow to 600 billion USD by 2030.[1] The additional liquidity generated by these facilities can help the GP manage indebtedness, provide interim liquidity to investors or supply additional capital to grow or support fund assets all while retaining future upside. NAV-based facilities can serve as an alternative to single company dividend recaps, M&A, IPOs, asset sales or secondary market solutions such as continuation funds.

## Overview

NAV-based facilities are credit facilities that are backed by the value of the fund's investments. Where subscription lines are backed by the undrawn commitments of the fund's LPs, NAV-based facilities are backed by the underlying portfolio. These facilities can be structured to cross-collateralize the equity of multiple portfolio companies.

The borrowing base (i.e., the total size of the facility) is calculated by the net asset value of fund interests/portfolio companies. If at any time the ratio of the facility exceeds the specified Loan-to Value (LTV) ratio, the terms of the facility may require the borrower to repay the loan whole or in part to return to the prescribed LTV limit. Alternatively, the facility may sweep cash generated from the underlying assets to bring the LTV ratio back into compliance. LTV ratios tend to decline over the life of the fund, as residual value of the equity in the portfolio reduces as assets are sold.

The collateral used in NAV-based facilities is generally cash received in the bank accounts of the borrowing entity, i.e., the fund or a fund subsidiary, together with a preferred equity interest in the fund's income and distributions from the fund investments. It can also extend to a direct or indirect pledge of the fund's equity investments, or a subset thereof.

NAV-based facilities are generally used after the remaining commitments of the fund have been drawn, and/or after the end of the investment period or early in the fund's harvest period, and/or after reserve capital has been exhausted. In some instances, the facility may be structured as a hybrid facility blended alongside a subscription line or other financing arrangements. Due to their additional structure and underwriting complexities, NAV-based facilities tend to have higher interest rates than do subscription lines. That said, because the facilities are cross-collateralized across multiple portfolio companies, NAV-based facilities tend to have a lower cost of capital than the debt a single portfolio company would be able to incur.

[1] 17 Capital, *In Defence of NAV Financing* (March 2024)

## Structure and Recourse

NAV-based facilities often involve creating two special purpose vehicles, or SPVs. The first SPV is created to incur the financing under the NAV facility and hold the equity interest of the second SPV (Holdco), which aggregates the underlying fund interests in the borrowing base. The structure of the SPVs can provide the lender the option when in default with the right to foreclose on the equity collateral. This could provide the lender with the ability to manage the underlying portfolio companies or force a sale.

Because portfolio companies are cross-collateralized, strong performing portfolio companies could be impacted in the event of a default. Lenders can have additional options upon default, including the rights to economic interests in the assets (e.g., proceeds from realizations), or the right to require the GP to make capital calls (if there are undrawn commitments remaining) and/or provide and adhere to a monetization plan.

Other types of NAV facility structures include but are not limited to fully secured loans (or notes) and flexible preferred equity structures where the fund itself is the borrowing entity.

Lenders note that a full foreclosure is a rare event. It is expected that if the facility is underperforming, the lender and the GP will work together to refinance or discuss other repayment options that do not involve the lender assuming control over the underlying portfolio.

The dual SPV structure created to implement the NAV facility can create challenges. Some GPs have taken the approach that the SPV does not count towards the calculation of fund-level leverage, meaning that the SPV is not restricted by typical fund-level leverage limits in LPAs.[2] It is ILPA's position that NAV-based facilities constitute fund-level leverage and, as such, should be included in borrowing limitations.

## Role of Lenders and Rating Agencies

Many different types of organizations provide NAV-based lending, including traditional banks, specialized funds (such as private credit funds) and direct lenders (such as insurance companies and pension funds). The lender conducts diligence on the manager, the fund and the selected portfolio companies before providing lending. Lenders can be expected in certain cases to engage a Nationally Recognized Statistical Rating Organization (a "rating agency") to evaluate the creditworthiness and risk profile of a transaction. Rating agencies will then evaluate the GP, the lender, the structure of the facility itself and the potential underlying assets on factors including financial strength, operating performance, leverage levels and risk management processes, in order to to assign credit ratings.

A higher credit rating typically translates to lower borrowing costs and potentially higher LTV ratios, as lenders perceive lower default risk. Conversely, lower credit ratings may result in higher borrowing costs to compensate for higher default risks.

[2] More information on this can be found in Part 5

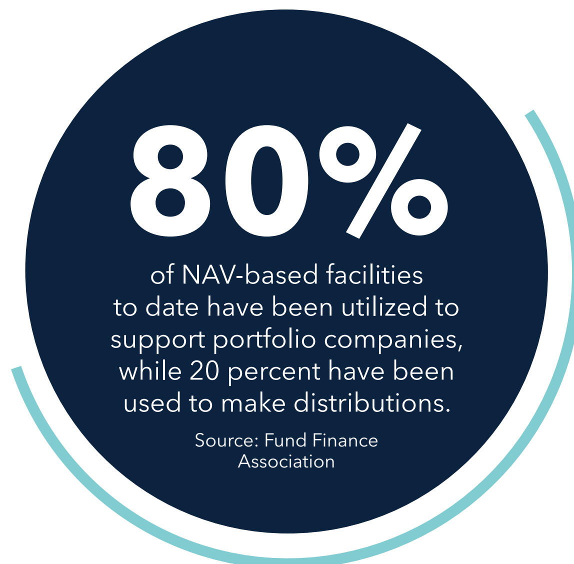
## Use Cases

Most commonly, GPs use the proceeds from NAV-based facilities to create early distributions, to generate liquidity to support the portfolio, or to fund follow-on investments.

When used to support the existing portfolio, proceeds can be used as defensive capital to protect portfolio value, for example by recapitalizing a portfolio company to reduce the cost of existing leverage. NAV-based facilities can also be used to finance value creation opportunities, such as capital for add-on acquisitions or other follow-on investments.

When used to fund an early distribution to LPs, proceeds can be, and often are, recallable. NAV-based facilities used for distributions are often in lieu of exits that generate cash realizations from individual portfolio companies, with a portion of future distributions used to repay the NAV facility.

The Fund Finance Association estimates that 80 percent of NAV-based facilities have been utilized to support portfolio companies, while 20 percent have been used to make distributions.




**More information on Early Distributions is available in Part 2.**

PART 2:

# LP Concerns Regarding NAV-Based Facilities

# LP Concerns Regarding NAV-Based Facilities

While NAV-based facilities can be a useful tool for capital structuring or to provide financing to support assets, their use today presents concerns for LPs. This section details specific issues that should feature in dialogue between LPs and GPs about these facilities.

**LPs often have limited insight into when NAV-based facilities are being used.** Some GPs have been proactive in discussing NAV-based facilities with LPs and/or LPAC members, while others have failed to provide adequate transparency. It is not uncommon for LPs to learn that their GPs are using a NAV-based facility through a review of distribution notices or other financial reporting, rather than from the GP directly.

> To fully understand the risks associated with their investment in the fund and across their entire portfolio, LPs need to know that a NAV-based facility is in place and the terms of that facility.

Second, **LPs struggle with the lack of governance related to the use of NAV-based facilities, which drives the lack of transparency.** These facilities are typically used after most of the fund commitments have been drawn, or after the fund investment period. As a result, funds that have a NAV-based facility in place tend to be older and are governed by LPAs that were drafted without any express reference to the use of NAV-based facilities.

**Where the LPA is silent, GPs have taken different approaches to how they treat NAV-based facilities.** Because an LPA often provides the LPAC with the authority to waive borrowing limitations that are expressly described in the document, some GPs have gone to LPACs to get approvals to use NAV-based facilities. However, these approval requests are often for a broad, general ability to use a facility during the life of the fund. They are not waivers or requests to use a specific facility, i.e., once a GP has the waiver, they may use a NAV-based facility multiple times.

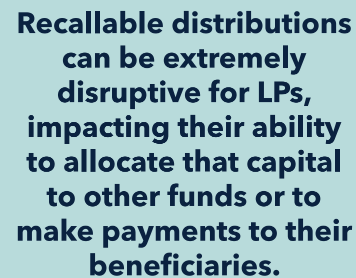
Furthermore, **some GPs have interpreted traditional fund-level leverage provisions in LPAs as providing sufficient authority for them to undertake NAV-based facilities without LP or LPAC notification or engagement.** As many NAV-based facilities involve the creation of an SPV below the fund, some GPs have interpreted LPAs to mean that NAV-based facilities are not captured by the fund-level leverage limits as prescribed in the LPA. Where NAV-based facilities are not included in fund-level leverage calculations, it is impossible for LPs to know how much leverage above the portfolio company level a GP can take out in the fund. This lack of transparency makes it challenging for LPs to properly assess the risks associated with the investment.

Lastly, **LPs have observed increased use of NAV-based facilities during the more challenging fundraising environments of recent years.** When used to provide early distributions to LPs, this practice leads to the inference that GPs are looking to improve DPI to attract LPs to commit to their next fund, rather than using NAV-based facilities as an accretive leverage tool. Additionally, distributions from NAV-based facilities come at a cost for most LPs, both due to the interest expense of these facilities and the often recallable nature of such distributions. Finally, due to heightened media attention surrounding NAV-based facilities, LPs are receiving more questions from their stakeholders, which can be challenging to address considering the limited and varied insight LPs have to the overall use of NAV-based facilities in their portfolio.

**More information on how GPs should engage the LPAC, and LPs more broadly, around NAV-based facilities can be found in Part 3. Detailed guidance on recommended disclosures to LPs can be found in Part 5.**

# In Focus: Use of NAV-Based Facilities for Early Distributions

The use of NAV-based facilities to generate early distributions presents challenges for LPs, given the impact on IRR/DPI, interest expenses associated with these vehicles, and the fact that such distributions are often recallable.




Early distributions generated by a NAV-based facility have a material impact on IRR and DPI performance figures, since capital is returned earlier than it would otherwise be if a NAV-based facility were not used. This impact can create perverse incentives for a GP to utilize a NAV-based facility in the absence of LP support, to improve their headline performance figures. Additionally, given the lack of transparency around the use of such facilities, more vigilance is required to isolate their impact, effectively requiring LPs to create a "synthetic" DPI figure to monitor a GP's performance. Furthermore, inconsistency in disclosure around the use of such facilities makes it harder to compare different GPs' performance figures during due diligence and the manager selection process.[3]

As mentioned, distributions generated from a NAV-based facility are often recallable; if the facility starts to underperform, i.e., falls out of compliance with the required LTV ratio, GPs can recall the distributed capital to pay down the facility. Recallable distributions can also be an administrative burden for LPs and disrupt their cash flow planning. The possibility that LPs will unexpectedly need to return distributions to the fund impacts LPs' ability to allocate that capital to other funds or strategies, or to distribute that cash to their beneficiaries. Additionally, recallable distributions create significant tax complexities for taxable LPs as well as accounting treatment challenges for insurance and other LPs. Many LPs are further frustrated when they must pay interest expenses on recallable distributions.

Lastly, NAV-based facilities come with significant interest expenses and other costs. These expenses may negatively impact returns for LPs, as they are often charged as partnership expenses. In cases where individual LPs in the fund are pushing for a distribution, there may be more cost-effective LP-led options that lead to better returns. These options include LP secondary sales or LP financing/credit solutions or even an LP-led NAV-based facility.

[3] More information on how ILPA recommends addressing performance reporting can be found on our Quarterly Reporting Standards Initiative webpages.

# In Focus: Use of NAV-Based Facilities for Portfolio Support

Separately, the use of these facilities to support the portfolio may also prompt LP questions or concerns. At the outset, funds should have significant and sufficient reserve capital to support portfolio companies after the end of the investment period, to fund potential follow-on investments or opportunitistic investments, or to support portfolio companies in challenging market environments. If a NAV-based facility is needed to support the portfolio and GPs do not engage LPs around the rationale for the facility, LPs may suspect that the GPs have mismanaged reserve capital or over committed the fund. This is why it is critical for GPs to be proactive in discussing the rationale behind the usage of a NAV-based facility with LPs.

Additionally, NAV-based facilities to support the portfolio may introduce cross-collateralization risk, particularly when a portion of the proceeds from a facility are used to support a struggling portfolio company with unclear future prospects. Differentiated returns are a key reason why LPs invest in private equity, but a facility of excessive size, particularly if secured by a blended group of assets with varying upside potential, could compromise a key factor in alpha generation within a private equity strategy.

Lastly, LPs are particularly wary of GPs that are struggling to fundraise utilizing a NAV-based facility to support the portfolio of their most recent fund, particularly after all capital has been called. LPs are concerned that struggling GPs may be taking out a NAV-based facility to increase their assets under management (and therefore their management fees if the management fee is calculated on cost). When a successor fundraise is challenged or in doubt, use of the facility might reflect a GP's drive to achieve carry and prove their viability. As a result, these situations present the greatest potential misalignment of interests associated with NAV-based facilities.

**More information on how to engage LPs can be found in Part 3.**

PART 3:

# Recommendations for Improved Transparency and LP Engagement

# Recommendations for Improved Transparency and LP Engagement

Transparency is vitally important for LPs to assess the risks associated with NAV facilities. This section provides guidance on how GPs should engage the LPAC and LPs more broadly when considering a NAV facility.

**More information about what type of information should be disclosed to LPs can be found in Part 5.**

## Current State

Currently, reporting and LP engagement around NAV facilities varies widely. The resulting gap in transparency is in large part because older LPAs do not contain provisions that explicitly consider or contemplate NAV facilities. In some cases, GPs have sought approval, or otherwise consulted, the LPAC which has resulted in transparency for at least LPs who have LPAC representation.[4] In other cases, GPs have not been proactive in reporting the use of NAV facilities to LPACs, much less to their LPs as a whole. In these cases, even LPs who sit on LPACs have discovered that their GPs are using NAV facilities only after the fact, often through financial reporting. LPs need transparency around the use of NAV facilities regardless of whether the proceeds are used to make a distribution or used to support the portfolio.

## Recommended Engagement of the LPAC in Advance of Implementing a Facility

Unless explicitly permitted by the LPA, or unless the GP has received prior consent to utilize a NAV facility, ILPA recommends that GPs seek LPAC consent prior to implementing a NAV facility, regardless of the use of proceeds. This engagement should encompass:

**Unless explicitly permitted by the LPA, or unless the GP has received prior consent to utilize a NAV facility, ILPA recommends that GPs seek LPAC consent prior to implementing a NAV facility, regardless of the use of proceeds.**

- **Rationale and use of proceeds:** A detailed disclosure of the use of proceeds, e.g., distributions to LPs, repayments of other borrowings or contributions to portfolio companies. This should include the rationale for the NAV facility as well as details on any alternatives considered, e.g., company-level financing, portfolio company realizations, continuation funds
- **Size, structure, and controls:** An overview of the facility size including amounts drawn at closing and any undrawn amounts available to be borrowed. This should also include a discussion of the use of SPVs; subordination; cross-collateralization; repayment requirements (including cashflow sweep or mandatory repayments); key covenants; and if the facility is secured or unsecured
- **Key economic terms:** To the extent permitted under lender restrictions, disclosure including cost of capital (including whether the interest rate is fixed or floating and cash interest or PIK interest); the maturity date of the facility, any repayment requirements as well as key covenants[5]
- **LP Obligations:** Any additional obligations imposed on LPs, including whether any distributions received are recallable

[4] More information about conflict waivers can be found in Part 4

[5] More information about what terms should be disclosed can be found in Part 5

### LP/LPAC Engagement: Specific Use Cases

Regardless of whether the LPA explicitly addresses NAV-based facilities, ILPA recommends that any conflicts of interest associated with a NAV facility be brought to the LPAC. Additionally, ILPA recommends that GPs take specific approaches to LPAC and LP engagement, depending on the intended use of proceeds:

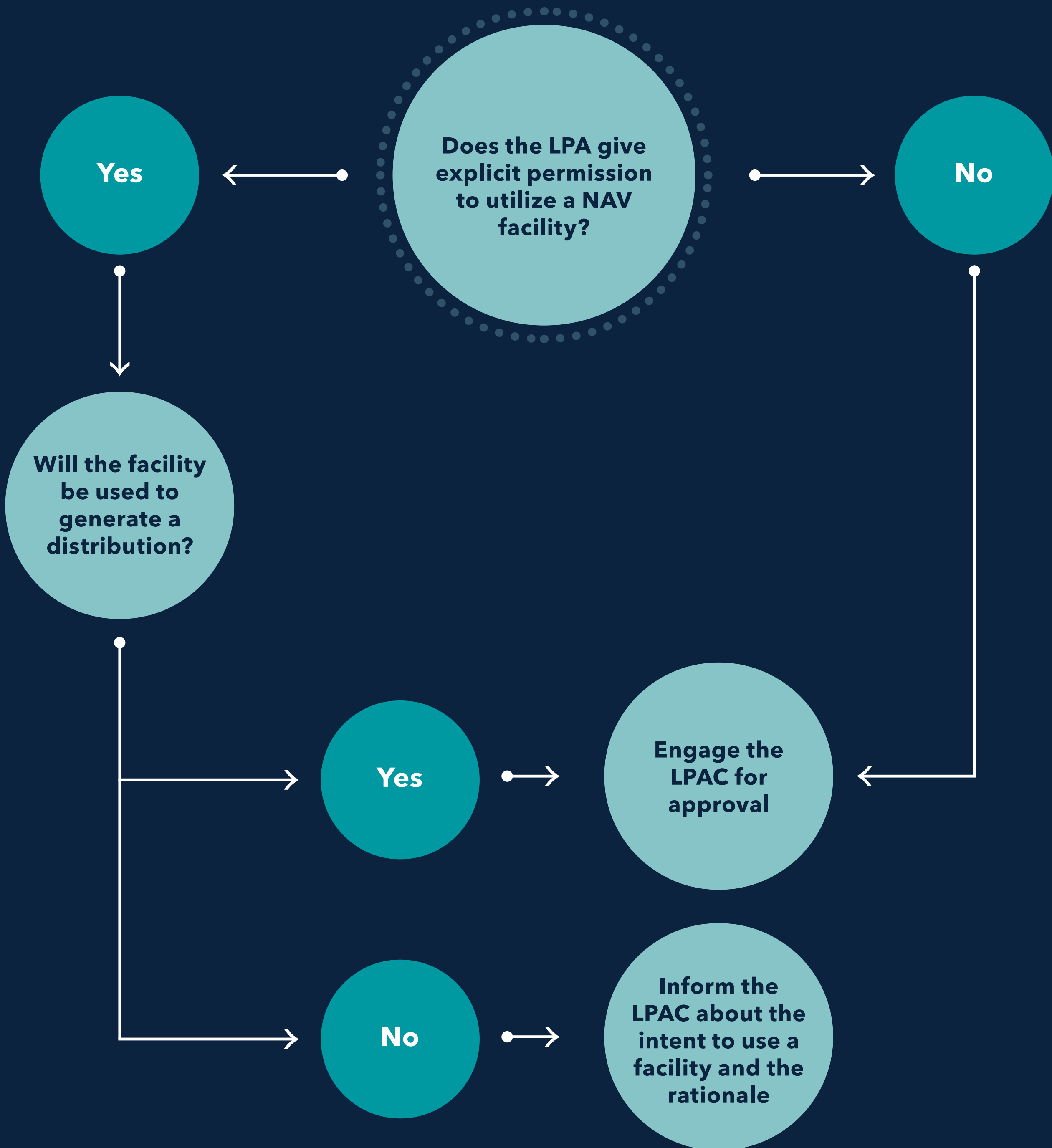
- **To Generate Early Distributions:** Prior to a NAV facility being put in place, GPs should seek LPAC approval if they intend to use any of the proceeds to generate a distribution. The GP should provide a rationale as to why a NAV facility is the best way to generate distribution proceeds, and how this facility will maximize returns for LPs while not incurring risks that exceed LPs' expectations. If the rationale for a facility is that a majority of the fund's LPs want an early distribution, there should be no issue receiving LPAC consent for such a transaction.

- **To Support the Portfolio:** Assuming that the GP has received prior consent to use a NAV facility (whether in the LPA or through prior LPAC approval), GPs should not be required to return to the LPAC for consent to use a NAV facility to support the portfolio. In these cases, this facility should be treated like more traditional leverage. LPs expect that it is the responsibility of the GP to manage the risks and expenses associated with leverage in the fund, and to comply with any fund-level leverage restrictions in the LPA.

**Regardless of the above, the GP should disclose to all LPs that it is implementing a NAV facility to support the portfolio. The GP should disclose the rationale behind the facility, why a NAV solution is better than other options available and the intended use of proceeds.**[6]

[6] More information about what terms should be disclosed can be found in Part 5

# When to Engage the LPAC around Implementation of a NAV Facility

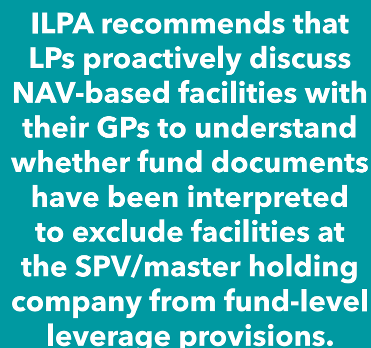


PART 4:

# Proposed Legal Documentation

# Proposed Legal Documentation

In this section, we review key legal terms in older LPAs that relate to NAV-based facilities and propose sample legal language for new LPAs that would establish clear expectations and guardrails regarding use of these facilities.




### GP Treatment of NAV-Based Facilities in Older LPAs

Because NAV-based facilities are a newer development in private equity fund finance, most older LPAs do not explicitly consider NAV-based facilities, which results in inconsistencies around how GPs treat them today. Some GPs have taken the approach that the existing borrowing provisions in older LPAs allow for discretion to implement a NAV-based facility without engaging the fund's LPs and/or seeking clearance from the LPAC.

Other GPs have taken the approach that they need LPAC consent or a waiver to utilize a NAV-based facility consistent with LPAC authority to approve deviations to the borrowing permitted under the LPA. In these instances, the GP requests the LPAC provide a waiver to broadly allow for use of NAV-based facilities. The waiver is generally not tied to a specific facility.

Where LPAs are silent on NAV-based facilities, LPs should review the fund borrowing provisions and the fund-level leverage provisions of the LPA. Specifically, the Limitation on Indebtedness provisions should prescribe what type of borrowing the fund is allowed to incur. Below is example language from the *ILPA Model LPA:*

> *7.2.1 The Fund may not borrow amounts, issue guarantees or otherwise incur indebtedness except on a short-term basis for periods of less than six months to finance investments pending receipt by the Fund of Drawdowns, provided (i) that any borrowing from the General Partner, the Fund Manager or their respective Affiliates shall (A) contain terms that are no less favorable to the Fund than could be obtained in arm's-length negotiations with unrelated third Persons for similar borrowings and (B) require the prior written consent of the Advisory Committee, and (ii) that, at any time, the aggregate liability of the Fund with respect to all such borrowing, guarantees and indebtedness does not exceed the lesser of (A) [X]% of the total Commitments and (B) the aggregate amount of Remaining Commitments.*

> *7.2.2 Subject to Section 7.2.1, the Fund Manager or the General Partner may establish a credit facility for the Fund with one or more financial institutions, pursuant to which the Fund's obligations are secured by a pledge or other grant of a security interest and the assignment by the General Partner to the relevant lender of the rights of the General Partner to deliver Drawdown Notices to the Limited Partners and to enforce all remedies against Limited Partners that fail to fund their respective Remaining Commitments in accordance with the terms hereof (a "Credit Facility".)*

Language similar to that in the *ILPA Model LPA*, which is relatively common, expressly allows the manager to take out a subscription line of credit but does not expressly consider a NAV-based facility with the fund or an SPV as a borrower. When they encounter an LPA with this type of language, LPs should ask their GPs if they interpret that they have the power to utilize a NAV-based facility, considering they are not expressly addressed in the LPA.

Fund-level leverage provisions limit the total amount of leverage that the fund can take out, generally as a percentage of overall commitments, remaining commitments or the net asset value of the fund. When a fund takes out a NAV-based facility, one or more SPVs or a master holding company are created below the fund-level, but above the portfolio companies, to incur the indebtedness. Some GPs have taken the view that the SPV or master holding company is technically outside the scope of the fund itself, and thus not included in any fund-level leverage limitations. As a result, LPs would not be able to know how much leverage the fund has taken out at the levels above the portfolio companies. Additionally, without LPA-imposed limits, GPs may be able to take out more leverage than would otherwise be prudent or utilize facility proceeds for reasons not aligned with the fund and LPs.

ILPA recommends that LPs proactively discuss NAV-based facilities with their GPs to understand whether fund documents have been interpreted to exclude facilities at the SPV/master holding company from fund-level leverage provisions.

## Addressing NAV-Based Facilities in Newer LPAs

Moving forward, newer LPAs should address NAV-based facilities to ensure a shared set of expectations and guardrails around permissible uses. New LPA language should delineate the reporting expectations around NAV-based facilities. Additionally, LPA language should clearly define limits to the amount of leverage that a GP is able to incur through NAV-based facilities throughout the life of the fund. This is critical to understand the risks associated with a potential fund investment. Lastly, LPA language should clearly define the term "NAV-based facility" so any SPV used counts toward the calculation of the leverage limit but does not encapsulate SPVs or borrowing structures set up to other forms of debt (i.e., single company portfolio debt.).

New LPAs should set shared expectations around how NAV-based facilities are reported. For example, the *ILPA Model LPA* requires:

*15.2.1 Until the final liquidation of the Fund, the General Partner shall cause the Fund to prepare and provide to each Limited Partner the following:*

> *15.2.2.8 the amount of debt for which the Fund generally, and any Portfolio Investment particularly, is directly or indirectly encumbered, as well as whether or not any such debt is recourse to the Fund or to a Portfolio Company or is cross collateralized among other investments or vehicles managed by any Interested Person.*
>
> *15.2.3.5 a report of the total debt and credit in use by the Fund, including with respect to any Credit Facility: (a) the balance and percentage of total uncalled capital; (b) the number of days outstanding of each Drawdown; (c) the current use of proceeds from each facility; (d) the net internal rate of return with and without the use of the Credit Facility; (e) the terms of the Credit Facility (including but not limited to any upfront fees as well as drawn and undrawn fees); (f) costs to the fund (including but not limited to interest and fees); and (g) any such further information the GP shall deem appropriate.*

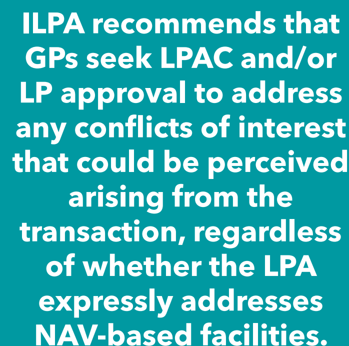
Additionally, borrowing provisions within new LPAs should include concepts that encapsulate NAV-based facilities, so that LPs are informed as to the amount of leverage a fund is able to incur through traditional fund-level leverage as well as through NAV-based facilities. For example:

> *The fund may incur indebtedness for borrowed money (including by way of entry into a subscription facility* ***or a NAV-based facility****) provided (i) that any Subscription Facility borrowing shall be on a short-term basis for periods of less than [six months] to finance investments pending receipt by the Fund of Drawdowns, (ii) that any borrowing from the General Partner, the Fund Manager or their respective Affiliates shall (A) contain terms that are no less favorable to the Fund than could be obtained in arm's-length negotiations with unrelated third Persons for similar borrowings and (B)* ***in the case of a NAV-based facility, require the prior written consent of the Advisory Committee,*** *and (iii) that, at any time, the aggregate liability of the Fund with respect to all such borrowing, guarantees and indebtedness* ***(including, without limitation, pursuant to a NAV-based facility)*** *does not exceed [X]% of the total Commitments and, in the case of a Subscription Facility, the aggregate amount of Remaining Commitments. For the avoidance of doubt, indebtedness incurred by a Borrowing Facility shall be subject to the restrictions in this section.*
>
> *"NAV-based facility" means any borrowing or preferred equity financing at the Partnership level or at the level of any Borrowing Subsidiaries for the purpose of facilitating or funding Investments (including for follow-on investments), paying or reimbursing Partnership Expenses or other Partnership obligations or financing distributions to Limited Partners, which borrowing or financing is secured in whole or in part by all or substantially all of the fund's assets including equity Investments or distributions in respect thereof.*
>
> *"Borrowing Subsidiary" means one or more Persons or arrangements formed beneath or alongside the Partnership or an Alternative Investment Vehicle to facilitate the obtaining, administering or securing of, or primarily in connection with, obtaining a NAV-based facility or similar borrowing arrangement, including such Persons or arrangements formed to hold more than one Portfolio Companies for such purpose.*

ILPA is not recommending a specific percentage threshold to limit the amount of NAV-based facility exposure. That exposure should be determined by LPs and GPs during fund negotiations based on the strategy of the fund and relevant risk factors. However, a clear limit is essential for LPs to understand the risks associated with their investments.

Additionally, new LPA terms should outline the role and responsibilities of the LPAC as it relates to NAV-based facilities. Specifically, the LPA should outline that the GP needs to obtain LPAC and/or LP approval for all conflicts of interest associated with a NAV-based facility.

ILPA recommends that GPs seek LPAC and/or LP approval to address any conflicts of interest that could be perceived arising from the transaction, regardless of whether the LPA expressly addresses NAV-based facilities.[7]




Finally, LPs should be wary of LPA provisions that give GPs broad authority to implement NAV-based facilities with little LPAC or broader LP oversight. LPs should also be wary of any language which preclears conflicts associated with NAV-based facilities or could be interpreted as doing so.

[7] Recommendations on how GPs should consider engaging the LPAC can be found in Part 3.

PART 5:

# Recommended Disclosures Related to the Use of NAV-Based Facilities

# Recommended Disclosures Related to the Use of NAV-Based Facilities

ILPA recommends that GPs provide all LPs within the fund with the following standardized disclosures about NAV-based facilities once they have been put in place.

## NAV-Based Facilities in Use: Rationale, Key Terms, Conflicts

| | |
|---|---|
| **01** | What is the rationale for using a facility, versus alternatives? Will it be used for to repay existing indebtedness, for follow-on investment, supporting the portfolio, for a distribution to LPs, etc.? Why is extra capital needed now?<br><br>*Answer here* |
| **02** | What is the overall size of the facility?<br><br>*Answer here* |
| **03** | What is the amount borrowed from the facility to date?<br><br>*Answer here* |
| **04** | What is the initial Loan to Value (LTV) ratio at the initial date of borrowing?<br><br>*Answer here* |
| **05** | Please describe the interest rate of the facility. Is the interest rate fixed or floating? If floating, please provide the base rate (e.g., SOFR, EURIBOR, SONIA) and the spread [=] bps. Is the interest required to be paid in cash or can it be paid-in-kind (PIK interest)?<br><br>*Answer here* |
| **06** | What is the tenor/term end date of the facility, including any extensions, if applicable? How is the facility meant to be repaid?<br><br>*Answer here* |

## NAV-Based Facilities in Use: Rationale, Key Terms, Conflicts

| | |
|---|---|
| **07** | Please describe the structure of the facility including the use of special purpose vehicles (SPVs) or subsidiaries.<br>*Answer here* |
| **08** | Please describe any security interests provided as collateral including interests in the underlying portfolio companies, any SPVs or subsidiaries as well as any pledge of uncalled capital.<br>*Answer here* |
| **09** | Describe the details of the financial covenants as well as other core items including cash sweeps and mandatory repayments. Include information on interest rate coverage ratio, security coverage ratio, LTV ratio and remaining portfolio company diversification.<br>*Answer here* |
| **10** | Please describe if a credit rating has been obtained through a Nationally Recognized Statistical Rating Organization ("rating agency"[8]).<br>*Answer here* |
| **11** | Please describe any potential conflicts of interest associated with the facility lender (e.g., is the lender a related entity?).<br>*Answer here* |
| **12** | Please describe any consents required and confirm that all required consents or waivers have been obtained.<br>*Answer here* |

[8] Note: Regulation may prevent ratings obtained through a Nationally Recognized Statistical Rating Organization from being shared to 3rd parties, such as limited partners

LPs should consider the following questions as a resource to support engagement with their GPs when a NAV-based facility is being proposed or put in place. Additionally, these questions can serve as a supplement to the questions on the use of fund finance within Section 7 of the *ILPA Due Diligence Questionnaire* (2021).[9]

## Questions to Guide LP Dialogue with GPs on NAV-Based Facilities

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|---|---|
| 01 | Is the amount of leverage resulting from the NAV facility appropriate given the rationale, existing asset-level leverage and other factors such as diversification/concentration in the fund's portfolio? Has the GP appropriately considered the increased risk when putting the NAV facility in place?<br><br>*Answer here* |
| 02 | Will proceeds be used in a way that is consistent with the best interests of the fund and the LPs? Has the GP reasonably demonstrated the impact of the NAV facility on returns to LPs in the fund?<br><br>*Answer here* |
| 03 | If the facility is used for a distribution, what is the impact of the NAV facility on the distribution (carried interest) waterfall? Does the facility trigger a payment of carried interest and is there any risk of a GP clawback arising from this distribution?<br><br>*Answer here* |
| 04 | If the facility is used to generate a distribution, will the management fee be reduced to reflect the distributed amounts?<br><br>*Answer here* |
| 05 | What is the impact of the NAV facility on uncalled commitments? If the facility is used to generate a distribution, will the distribution be recallable? Is there a pledge of uncalled commitments?<br><br>*Answer here* |

[9] ILPA, *Due Diligence Questionnaire* (Nov. 2021)

## Questions to Guide LP Dialogue with GPs on NAV-Based Facilities

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|---|---|
| **06** | Is the leverage resulting from the NAV facility included as "fund leverage" in the measure of fund-level leverage as defined in the LPA, e.g., within borrowing provisions?<br><br>*Answer here* |
| **07** | Do any LPs have side letter or exclusion rights that may lessen their exposure to the facility?<br><br>*Answer here* |
| **08** | Will details about the facility be disclosed in the fund's audited financial statements, even if an SPV or other vehicle that sits below the fund has been used for the facility?<br><br>*Answer here* |
| **09** | Who at the GP is responsible for monitoring the usage and performance of the facility, including monitoring LTV ratios and other covenants?<br><br>*Answer here* |

LPs should also consider qualitative factors beyond the contractual terms of the NAV facility. ILPA recommends that LPs assess the following to understand the impacts and potential risks associated with a NAV facility:

- The GP's recent track record and current circumstances, e.g., health of the portfolio, sectoral challenges, status of current fundraise
- Age of the fund and performance relative to fund hurdle, i.e., is the fund near the end of life but the GP is below the hurdle rate?
- The GP's historical management of debt and leverage at the fund and the portfolio company level
- Appropriate valuation processes and finance function oversight of compliance with facility covenants

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